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No. 173

In the Supreme Court of the United States

OCTOBER TERM, 1951

JOSEPH T. LYKES, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The memorandum opinion of the District Court (R. 26-31) is reported at 84 F. Supp. 537. The opinion of the Court of Appeals (R. 33-38) is reported at 188 F. 2d 964.

JURISDICTION

The judgment of the Court of Appeals was entered April 27, 1951. (R. 38.) The petition for a writ of certiorari was filed July 5, 1951, and was granted October 8, 1951 (R. 40). The jurisdiction of this Court rests on 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether expenses incurred by a donor of property in litigating a deficiency in gift tax are deductible from his gross income, in the computation of income tax, under Section 23(a)(2) of the Internal Revenue Code and the applicable Treasury Regulations.

STATUTE AND REGULATIONS INVOLVED

These are set forth in Appendix A, *infra*, pp. 37 to 43.

STATEMENT

The facts as stipulated (R. 10-12) and found by the District Court (R. 26-28) may be summarized as follows:

Taxpayer is a stockholder in Lykes Brothers, Inc., a family corporation whose stock has been closely held throughout its existence. In 1940, taxpayer made gifts aggregating 1,000 shares of the stock to his wife, son, and two daughters, giving to each 250 shares. He filed a gift tax return in which he stated that the motive for his gifts was love, valued the stock at $120 per share, and paid a gift tax of $13,032.75. In 1944 the Commissioner of Internal Revenue formally notified taxpayer of a gift tax deficiency for 1940 in the amount of $145,276.50, which deficiency was based upon a valuation of the stock at $915.50 per share. Taxpayer engaged an attorney, who prepared and filed with the Tax Court a petition for redetermination of the gift tax deficiency. In 1946, a compromise

settlement was reached before trial and, pursuant to stipulation of the parties, the Tax Court found a deficiency in gift tax in the sum of $15,612.75, which was promptly paid. Taxpayer paid his attorney $7,263.83 in 1944 for legal services in this matter. (R. 10-12, 26-28.)

In his income tax return for 1944, taxpayer did not deduct the attorney's fee from his gross income. Thereafter he filed a claim for refund on the ground that the fee was deductible under Section 23(a)(2) of the Internal Revenue Code. (R. 4A-4B.) The claim was denied by the Commissioner (R. 7), and taxpayer sued for refund.

The District Court held that the claimed deduction was allowable under Section 23(a)(2), and that Section 29.23(a)-15(b) of Treasury Regulations 111, which prohibited the deduction, was unauthorized and invalid. (R. 26-31.) The Court of Appeals reversed. (R. 33-38.)

SUMMARY OF ARGUMENT

I

Section 23(a)(2) of the Internal Revenue Code authorizes the deduction from gross income of a limited class of non-business expenses, namely, those incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." It was added to the Code for the restricted purpose of affording relief to taxpayers

whose non-business activities produced taxable income, but whose expenses connected with such activities were not deductible as "business" expenses under Section 23(a)(1).

The expense here in question, consisting of the payment of an attorney's fee for services in contesting an asserted deficiency in gift tax, was directly connected with, and resulted solely from, a gift of stock. A gift is a personal transaction having no relation to any of the activities specified in Section 23(a)(2). Expenses connected with the gift are not expenses incurred "for the production or collection of income," within the meaning of Section 23(a)(2); since a gift is a non-taxable event which produces no gain or loss for income tax purposes. Nor are they expenses incurred "for the management, conservation, or maintenance of property held for the production of income," within the intent of that section, since they are incurred in the process of transferring ownership of the property and its future income from one taxpayer (the donor) to another (the donee). A taxpayer does not manage or conserve his income-producing property, nor does he hold it for the production of income, by giving it away. On the contrary, the effect of the gift is to diminish the taxpayer's property and, correspondingly, his income from property. That the expense was incurred in litigation with the Government does not alter the nature of the expense. It is immaterial

whether the donor's expenses connected with the gift are incurred for services in preparing the necessary gift documents or gift tax returns, or in resisting claims of third persons who might attack the gift, or, as here, in resisting a claim of the Government under the gift tax statute. Assuming that such expenses are ordinary and necessary in the sense that they are normal and reasonable in amount, they are ordinary and necessary personal expenses connected with a gift, the deduction of which is barred by Section 24 (a) (1), rather than permitted by Section 23 (a) (2).

That the donor may be required to liquidate some of his income-producing property in order to pay a gift tax deficiency does not serve to transform an expense incurred in contesting the deficiency from one relating to a gift into one incurred "for the management, conservation, or maintenance of property held for the production of income." To treat it as deductible for that reason would sanction the deduction of expenses incurred in defending any personal law suit which might result in a judgment lien against the taxpayer's income-producing property, and defeat the statutory ban against personal expense deductions. Expenses of gift tax litigation would not be deductible "business" expenses under Section 23(a)(1) merely because the gift tax might become a lien on the donor's business property. By the same token, such expenses are not deductible under Section 23(a)(2) merely

because the gift tax might become a lien on his non-business income-producing property.

Nothing in the opinion of this Court in *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, upon which the District Court relied, supports the deduction of expenses of litigating gift tax liability. In that case administration expenses of a trust, relating to the distribution of the trust property, including expenses of litigating income tax liability, were held deductible on the ground that they were incurred by the trustees in discharge of their fiduciary duties and hence were proximately related to the "management" of the trust enterprise. A voluntary gift, as distinguished from a distribution by trustees, is not an act of management. In the only other case involving the question here presented, both the Tax Court and the Court of Appeals, in soundly reasoned opinions concurred in by the court below, properly distinguished the *Bingham* case and denied the deduction.

Taxpayer's contention that the gift tax deficiency was arbitrarily asserted by the Government has no support in the record or in the findings of the District Court. But even if the deficiency had been asserted without a reasonable basis, that would not convert the expense from one connected with the gift into one incurred for the purposes designated in Section 23(a)(2).

The taxpayer's contention that his motive for transferring the stock to his wife and children was

not only love but also to maintain the family interest in the corporation does not support the deduction of the expense. Gifts to members of the taxpayer's family may maintain the family interest, but they decrease the taxpayer's own interest. Even assuming that giving away one-third of one's property is an ordinary and usual method of producing income and conserving the remainder, the argument proves too much, since it leads to the absurd result that the gift itself is a deductible expense.

II

The applicable Treasury Regulation, promulgated after the *Bingham* decision, explicitly prohibits deduction of expenses incurred in the determination of gift tax liability. The regulation is in harmony with the statute and its legislative history. Even assuming that the statute could reasonably be construed as authorizing the claimed deduction, the interpretation placed upon it by the Treasury —the agency charged with its administration and authorized to promulgate interpretive regulations —is also a permissible one; and this Court has repeatedly held that a Treasury Regulation must be sustained unless plainly inconsistent with the statute. Moreover, the applicable regulation must be deemed to have received implied legislative approval by virtue of substantial re-enactments of the statutory provision to which it is addressed.

III

The court below did not exceed its powers of review in reversing the District Court. This case presents a reviewable question of law turning on the meaning and intent of Section 23 (a) (2). Furthermore, the District Court did not rest its decision on any factual determination that the expense was proximately related to the production of income or to the management of income-producing property; it allowed the deduction because of its conviction that such result was required as a matter of law, and that the Treasury Regulation barring the deduction was invalid. Even if this case were viewed as presenting only a question of fact, the District Court's decision is clearly erroneous and was properly reversed, since the undisputed fact that the expense was incurred in gift tax litigation precludes any finding that it satisfied the conditions of the statute. No useful purpose would be served by remanding the case to the District Court, for that court could make no further findings which could bring the expense within the class allowed by the statute.

ARGUMENT

I

The Claimed Deduction Is Not Allowable under Section 23(a)(2) of the Internal Revenue Code

This case turns on the construction of Section 23(a)(2) of the Internal Revenue Code (Appendix A, *infra*, p. 37) which authorizes the deduction

from gross income, in the computation of income tax, of ordinary and necessary expenses incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The facts dispositive of the case are not in dispute. The claimed deduction is for an expenditure made by taxpayer in 1944 for legal services in contesting a gift tax deficiency asserted by the Government. The gift was of stock in a closely held family corporation, and was made to members of the taxpayer's family. The gift tax litigation arose because of different valuations placed upon the stock by the taxpayer and the Commissioner, and was settled before trial at a compromise figure. (R. 10-12, 26-28, 34.)

The Commissioner disallowed the claimed deduction, in keeping with the applicable Treasury Regulation (Section 29.23(a)-15(b), Appendix A, *infra*, pp. 40-43), which provides that "expenses paid or incurred by an individual in the determination of gift tax liability . . . . are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability." The District Court made no finding that the expense in question was incurred for or related to any of the purposes specified in Section 23(a)(2).[1] It held that to construe that

[1] While it referred to certain testimony and contentions of the taxpayer, it made no findings with respect to them, nor did it attempt to appraise their relevancy or significance. (R. 27-28.)

section as not embracing expenses of gift tax litigation would be a denial of "justice," and that the Treasury Regulation prohibiting the deduction of such expenses was unauthorized. (R. 30-31.) The Court of Appeals disagreed. Following the decision of the Tax Court and the Court of Appeals in *Cobb* v. *Commissioner*, 10 T. C. 380, affirmed, 173 F. 2d 711 (C.A. 6th), certiorari denied, 338 U. S. 832, rehearing denied, 338 U. S. 882, it held that expenses incurred in litigating gift tax liability do not fall within the purview of Section 23(a)(2), and that in any event the regulation must be sustained as a reasonable and permissible interpretation of that section. (R. 35-38.) We submit that the Treasury Regulation and the decision of the Court of Appeals sustaining it are fully in accord with the applicable statutory provisions, their legislative history, and the decisions of this Court.

A. *The provisions of Section 23(a)(2) and their legislative history*

The income taxing statute draws a distinction between expenses relating to personal transactions, and those related to income-producing activities. Section 24(a)(1) of the Internal Revenue Code (Appendix A, *infra*, p. 38), provides that "In computing net income no deduction shall in any case be allowed in respect of . . . Personal . . . expenses." Section 23(a)(1)(A) (Appendix A, *infra*, p. 37), authorizes the deduction of expenses

incurred "in carrying on any trade or business," provided they are ordinary and necessary. Section 23(a)(2) authorizes the deduction of a limited class of "non-business expenses," namely, those incurred "for the production or collection of income" or "for the management, conservation, or maintenance of property held for the production of income," provided they are also ordinary and necessary.

Section 23(a)(2) was added to the Code by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, for the restricted purpose of affording relief in situations like that presented in *Higgins* v. *Commissioner*, 312 U.S. 212, wherein this Court held that an investor in income-producing securities was not carrying on a "business" and hence was not entitled under Section 23(a)(1) to deduct expenses incurred in managing his investments and collecting the income therefrom. In referring to the legislative background of Section 23(a)(2), this Court stated in *McDonald* v. *Commissioner*, 323 U.S. 57, 61-62:

> This amendment was proposed by the Treasury (1 Hearings before Committee on Ways and Means, Revenue Revision, 1942, 77th Cong., 2d Sess., p. 88) to afford relief for a specifically defined inequitable situation which had become manifest by the decision of the Court in *Higgins* v. *Commissioner*, 312 U.S. 212. In that case this Court held that by previous enactments Congress had made no pro-

> vision for allowable deductions from profitable transactions not covered by the statutory concept of "business" income. * * * Congress adopted the Treasury proposal for the restricted purpose which originated it. * * * The amendment of 1942 merely enlarged the category of incomes with reference to which expenses were deductible.

Attached to this brief as Appendix B, *infra*, pp. 43-46, is a copy of the House Committee Report which accompanied the Revenue Bill of 1942. It is clear from the Report that Section 23(a)(2) was designed to place expenses incurred in producing non-business income on a parity with those incurred in producing business income, since both types of income were subject to the income tax. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-75 (1942-2 Cum. Bull. 372, 410, 429-430); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571. "The effect of § 23(a)(2) was to provide for a class of non-business deductions coextensive with the business deductions allowed by § 23 (a) (1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income." *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, 374. See also Section 29.23 (a)-15(a) of Treasury Regulations 111 (Appendix A, *infra*, pp. 38-40).

B. *Gift expenses are not within the purview of Section 23(a)(2)*

Expenses incurred by a donor in connection with a gift of income-producing property, including expenses of litigating gift tax liability, do not fall within the limited class of non-business expenses allowable as deductions from gross income under Section 23(a)(2). To hold otherwise would do violence to the Congressional intent revealed by the language of the statute and its legislative history.

Expenses connected with a gift of property are not incurred "for the production or collection of income," within the meaning of Section 23(a)(2), since a gift has nothing to do with the production or collection of income. The purpose and effect of a gratuitous transfer of income-producing property are to change the ownership of the property and the income subsequently produced by it, a transaction which results in no gain or loss for income tax purposes.[2] And far from constituting expenses incurred "for the management, conservation, or maintenance of property held for the production of income," within the meaning of that section, expenses connected with a gift of income-producing property are incurred in the process of transferring ownership and management of the

[2] A gift of property is not a taxable event for income tax purposes. The income from the property is thereafter taxable to the donee (Section 22(b)(3)), and the donee acquires the donor's "basis" for determining gain or loss on a later sale or exchange of property (Sections 111, 113(a)(2) and (b)). Deduction of the gift taxes is expressly barred by Section 23(c)(1)(D).

property from one taxpayer (the donor) to another (the donee). A taxpayer obviously does not "manage" or "conserve" his property by giving it away.[3] On the contrary, the gift operates to diminish the amount of "property held for the production of income" by the donor and, correspondingly, the amount of "income" from such property.[4] In short, expenses which result from a gift of property (including expenses of litigating gift

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[3] There can be no quarrel with the taxpayer's observation (Br. 30-31) that gifts *inter vivos* are a recognized means of distributing ones estate. But such a distribution is not, as the taxpayer assumes (Br. 29-30), the kind of "distribution" with which this Court was dealing in the *Bingham* case. Estate planning is by no means synonymous with the management of a person's own estate, or (as in the *Bingham* case) of a trust estate. It deals, rather, with the distribution of estates and the income therefrom in a way which will minimize tax liabilities and the other hardships or inconveniences which might result from the continued ownership of large amounts of property by an individual. When gifts are made within the family group, there may be an ultimate saving of taxes to the family as a unit. But neither the impact of the income tax law nor the deductions permitted by Section 23(a)(2) is based on the family unit; they apply to the taxpayer individually (See *Cobb* v. *Commissioner*, 173 F. 2d at 715). A gift of property, however wise from an estate point of view, disrupts the very holding of property by the taxpayer, which is the basis for a deductible expense. Before the gift, the property was held for the production of income by the donor as an individual; after the gift, it is held by someone else.

[4] Conversely, the donee (who is liable for the gift tax to the extent of the value of the gift, under Code Section 1009) would not be entitled to deduct the expense of litigating the gift tax, since the expense would be incurred in the course of obtaining the property, not for the management or conservation of property already "held" by him for the production of income. Cf. *McDonald* v. *Commissioner*, *supra*, wherein this Court held (p. 60) that the campaign expenses of a judge seeking election "were not expenses incurred in being a judge but in trying to be a judge", and hence (p. 62) "were not incurred in 'carrying on' his 'business' of judging."

tax liability) can not be deemed expenses proximately related either to the production of income or the management of income-producing property within the meaning and intent of Section 23(a)(2). They are in the nature of personal expenses attributable to the donor's act of giving away his property, the deduction of which is proscribed by Section 24(a)(1). Cf. *Commissioner* v. *Flowers*, 326 U.S. 465. It is the "origin and nature" of the expense which is determinative of the right to the deduction. *Deputy* v. *duPont*, 308 U.S. 488, 494; *Interstate Trunsit Lines* v. *Commissioner*, 319 U.S. 590, 594.[5]

The circumstance that the expense in question was incurred in litigation with the Government does not serve to transform it from a non-deductible expense into a deductible one. The crucial fact remains that the litigation, and the expenses connected with it, proximately resulted from, and were directly connected with, a gift.

It is immaterial whether the donor's expenditures in connection with the gift are for services in preparing the necessary gift documents and

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[5] In the *Interstate Transit Lines* case this Court stated (p. 594) that—

> The mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction under § 23 (a). That subsection limits permitted deductions to those paid or incurred "in carrying on any trade or business." The origin and nature, and not the legal form, of the expense sought to be deducted determines the applicability of the words of § 23 (a).

gift tax returns, or in resisting claims of third persons who may attack the gift, or, as here, in resisting gift tax liability asserted by the Government under the gift tax statute. Granting that such expenditures are ordinary and necessary in the sense that they are normal and are reasonable in amount,[6] they are ordinary and necessary expenses falling outside the ambit of Section 23(a)(2). Cf. *Commissioner* v. *Flowers, supra; Higgins* v. *Commissioner, supra.* The issue here is not whether the expense satifies the statutory requirement that it be an ordinary and necessary one, but whether it falls within the limited class of ordinary and necessary non-business expenses which Congress has authorized as deductions. The question of whether a particular expense is ordinary and necessary is not reached unless it can be shown that the expense meets the basic statutory requirement that it is incurred "for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income." See Section 29.23(a)-15(a) of Treasury Regulations 111. H. Rep. No. 2333, *supra*, pp. 74-75. Since the expense in question was directly connected with and resulted solely from a gift of property, this basic requirement has not here been met.

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[6] Cf. *Commissioner* v. *Heininger*, 320 U.S. 467; *Welch* v. *Helvering*, 290 U.S. 111, 114; *Deputy* v. *duPont*, *supra*, pp. 494, 495; *Kornhauser* v. *United States*, 276 U.S. 145, 153. The Commissioner concedes, as he did below (R. 28), that the expenditure in question was reasonable in amount.

The taxpayer argues that the expense is deductible because it was incurred to protect income producing property from the asserted gift tax deficiency (Br. 24-25, 27, 32). But the circumstance that a taxpayer may be required to use property or funds (whether or not income-producing) to satisfy a claim against him affords no basis for treating expenses incurred in resisting the claim (successfully or unsuccessfully) as expenses incurred "for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income," as that language is used in Section 23(a)(2). To treat the expense as deductible for that reason would require the allowance of expenses incurred in defending virtually any claim or law suit, including those of a personal nature (e.g., for personal injuries, or for residential rent or taxes), that might result in a judgment lien on the taxpayer's property.[7] This would defeat the legislative mandate that no deductions for personal expenses shall be allowed. Clearly a taxpayer engaged in a business would not be entitled to deduct as a "business" expense allowable under Section 23(a)(1) expenses incurred in gift tax litigation merely because the gift tax might become a lien on his business property. The expenses would

[7] Moreover, the deductibility of the expense would turn on how much property the taxpayer has available for satisfaction of the claim, and what portion of it if any consists of income-producing property, considerations having no bearing upon the nature of the expense.

plainly lack the requisite relationship to the carrying on of the business. *Kornhauser* v. *United States, supra; Commissioner* v. *Heininger, supra; Deputy* v. *duPont, supra.*[8] By the same token, the expense is not deductible under Section 23(a)(2), which is in *pari materia* with Section 23(a)(1) (*Bingham's Trust* v. *Commissioner, supra,* pp. 373, 374), merely because the gift tax might become a lien on his non-business income-producing property, since it is not proximately related to any activity ("business") of producing income or of managing and conserving property for the production of income. As the court below observed (R. 37) "such expense is not one directly incurred in managing or conserving such property, nor is it a proximate result of holding property for the production of income, any more than fees or expenses incurred in any other type of personal, as distinguished from business, litigation (e.g., an ordinary tort action) which might result in a lien upon the taxpayer's income-producing property."

The provisions of Section 23(a)(2) must of course be examined in the light of the "now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of

[8] The only deductions which Congress has seen fit to allow on account of gifts by individuals or corporations are those specifically authorized in Sections 23(o) and 23(q); namely, contributions to charitable and similar organizations, and the amount deductible is limited to a percentage of the donor's income. Such contributions are exempt from the gift tax by Section 1004(a)(2).

clearly showing the right to the claimed deduction is on the taxpayer." *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593. See also *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *Deputy* v. *duPont*, 308 U.S. 488, 493; *Commissioner* v. *Jacobson*, 336 U.S. 28, 48-49; *McDonald* v. *Commissioner*, *supra*, p. 60. This rule acquires added significance in terms of the issue here presented, since the authorization in Section 23(a)(2) of deductions of certain non-business expenses must be read in conjunction and harmonized with the omnibus prohibition in Section 24(a) of deductions for personal expenses "in any case." Cf. *Commissioner* v. *Flowers*, 326 U.S. 465.

The District Court was of the opinion that to construe the statute as barring deduction of expenses incurred in contesting a gift tax deficiency "isn't justice under the law." (R. 30.) But whether an expense qualifies for deduction does not, as the District Court assumed (R. 30), turn on general equitable considerations. *Deputy* v. *duPont*, *supra*, p. 493; *Boehm* v. *Commissioner*, 326 U.S. 287, 295. Cf. *Rothensies* v. *Electric Battery Co.*, 329 U.S. 296.

Inherent in making a gift of property which, as in this case (R. 26-27), has no readily ascertainable market value, is the possibility that the Commissioner's valuation of the gift property may not coincide with the donor's. In such case the donor has the right, which he pursued with partial success in this case, of petitioning the Tax Court

for a redetermination of the deficiency (R. 27-28), and also of appealing from the Tax Court's decision. While the District Court stated that the taxpayer "contends" that the Commissioner's gift tax deficiency determination was "arbitrary and capricious" (R. 28), it made no finding to that effect, nor would the record support any such finding had it been made.[9] In any event, even assuming arguendo that the Commissioner's valuation was arbitrary, that would not serve to convert what is otherwise a non-deductible expense into a deductible one. In the words of this Court in *Deputy* v. *duPont, supra* (p. 493)—

> But allowance of deductions from gross income does not turn on general equitable considerations. It "depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440.

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[9] "All of the economic benefits of [property] must be taken into consideration in determining its value for gift tax purposes." *Guggenheim* v. *Rasquin*, 312 U.S. 254, 257. The Commissioner's gift tax deficiency notice, valuing the donated stock at $915.50 per share, stated that such valuation "is based upon consideration of the pertinent factors having a bearing upon the fair market value of such stock. Primary weight was given to the nature of the business and the net worth of the company." (Stipulation, Ex. 2 (R. 11) not made part of the printed record by reason of the granting of taxpayer's motion (Petition for certiorari, p. 10) to dispense with its printing.)

The stock was not listed on any exchange, and there had never been any sale of a substantial amount of it (R. 19, 26-27); moreover, the earnings of the corporation admittedly were dependent upon "many factors" and ran "more or less in cycles" (R. 20).

The taxpayer points to the financial hardship to which a donor is subjected when the Commissioner's valuation of gift property substantially exceeds his valuation and he is denied the right to deduct expenses of contesting the asserted gift tax deficiency in computing his income tax. Similar hardships confront a taxpayer of course in any case where a substantial personal claim is asserted against him and he is put to the expense (concededly non-deductible) of resisting it; for example, a suit to recover damages for accidental injury to private or governmental property. Any desired relief lies with Congress, however, not the courts. In answering like contentions of the taxpayer in *Boehm* v. *Commissioner*, *supra*, a case involving a claimed loss deduction under Section 23(e), this Court stated (p. 295):

> But these difficulties are inherent under the statute as now framed. Any desired remedy for such a situation, of course, lies with Congress rather than with the courts. It is beyond the judicial power to distort facts or to disregard legislative intent in order to provide equitable relief in a particular situation.

The taxpayer's contention that his motive for transferring the stock was not only love but also to maintain the family interest in the corporation, to achieve continuity of management, and to fortify the value of the stock retained by him does not justify the deduction (R. 19-21). The argument really combines (and confuses) three separate

ideas, none of which, separately or in combination, supports the taxpayer's claim.

(a) The first concept is really one of estate planning—the objective of retaining control of the corporation in the family as a unit. As we have pointed out above, footnote 3 *supra*, p. 14, this may be a sound enough policy, but it does not support a claim that the gift is a part of the management of the taxpayer's own property.

(b) The second concept is that it is sound business, from the point of view of the corporation, to interest the younger members of the family in its management, so as to assure continuity; but that does not aid the taxpayer in establishing that the gift served to produce income for him or to conserve or maintain his personal property. *Deputy* v. *duPont*, *supra*, at pp. 493-494; *cf. Interstate Transit Lines* v. *Commissioner*, *supra*.[10]

(c) The third concept is that the hoped-for participation in the management of the corporation by the donees would increase the taxpayer's earnings as a stockholder and thereby fortify the value of the shares retained by him. This theory really has no application to the gifts to the two unmar-

[10] In the *duPont* case, a stockholder attempted to deduct expenses incurred under a plan to increase the efficiency of the management of his corporation by selling stock to key executives. This Court stated, at page 494, "The fact that the transaction out of which the carrying charges here in question arose might benefit respondent does not bring it within the ambit of his alleged business of conserving and enhancing his estate. The well-established decisions of this Court do not permit any such blending of the corporation's business with the business of its stockholders."

ried daughters (one of whom was a minor) or to the wife; the taxpayer's own testimony attempted to support the argument only by reference to the gift to his son, who was a minor at the time but who has since reached his majority and become active in the corporation (R. 24-25, 21). Aside from the question of whether it would be an "ordinary" method of producing income, or of managing or conserving one's property, to give away a third of it, the main fault with the argument is that it proves too much. If a gift of stock were deemed an act designed to profit the donor, the amount of the gift itself would be a deductible expense under Section 23(a)(2). No such deduction is or can be claimed by the taxpayer, and the reasons which preclude it apply *a fortiori* to expenses incidential to the gift.

C. *The decision below is in accord with the decisions of this Court*

In dealing with business expense deductions claimed under Section 23(a)(1) this Court has repeatedly held that to qualify for deduction the expense must be directly connected with or proximately result from the carrying on of the business. *McDonald* v. *Commissioner, supra; Commissioner* v. *Flowers, supra; Commissioner* v. *Heininger, supra, Deputy* v. *duPont, supra; Interstate Transit Lines* v. *Commissioner, supra; Kornhauser* v. *United States*, 276 U. S. 145. The same test applies to deductions claimed under Section 23 (a) (2),

which is *in pari materia* with Section 23 (a) (1), except that the expense must be directly connected with or proximately result from carrying on activities of producing income, or managing or conserving income-producing property. *Bingham's Trust* v. *Commissioner, supra; McDonald* v. *Commissioner, supra.*

Gift tax litigation expenses—whether the gift is of business or non-business assets—cannot meet that test for the simple reason that such expenses are proximately related to the gift, a personal transaction having nothing to do with the conduct of a business or with the production of non-business income or the management of non-business property. It could not be seriously contended that a taxpayer engaged in business who made a gift of some or all of his business assets would be entitled under Section 23(a)(1) to deduct expenses of litigating gift tax liability as expenses proximately related to the conduct of his business. A taxpayer who makes a gift of some or all of his non-business assets can stand on no different footing, for a gift is no more proximately related to the carrying on of the non-business activities described in Section 23(a)(2) than to the carrying on of business activities.

Nothing in the opinion of this Court in *Bingham's Trust* v. *Commissioner, supra,* upon which taxpayer relies, detracts from its earlier observation (*McDonald* v. *Commissioner, supra,* p. 62)

that Section 23(a)(2) was enacted "for the restricted purpose which originated it," or suggests that expenses of litigating gift tax liability are embraced by that restricted purpose. In the *Bingham* case the testamentary trustees of a residuary estate paid fees for legal advice on problems related to final distribution of the trust fund, and for legal services in contesting an *income* tax deficiency based upon appreciation of the value of securities turned over to a legatee in lieu of cash. The Government challenged the deduction of these expenses on the ground that they were incurred after the trust term had expired, and hence at a time when the trust property was ready for distribution and no longer held for the production of income. After stressing that Section 23(a)(2) authorizes the deduction of expenses for the "management" of income producing property, as well as for the production of income, this Court stated (~~pp. 375-376~~):

> But the duties of the trustees were not only to hold the property for the production of income and to collect the income, but also, in administering the trust, to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties is an integral part of carrying out the trust enterprise. Accordingly, as the Tax Court held, the costs of distribution here were quite as much expenses of a function of "management" of the trust

property as were expenses incurred in producing the trust income; and if "ordinary and necessary," they were deductible.

* * * * * *

What we have said applies with equal force to the expenses of contesting the tax deficiency. Section 23(a)(2) does not restrict deductions to those litigation expenses which alone produce income. On the contrary, by its terms and in analogy with the rule under § 23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income.

The Court also (pp. 375-377) relied upon provisions of the Treasury Regulations dealing with administration expenses of trustees, and stated that insofar as those provisions purported to allow deductions only of litigation expenses related to "production" of income, and to deny those related to "management" of the trust estate, they would not be in conformity with the statute.

The vital difference between this and the *Bingham* case is that the expenses of the Bingham trustees were not incurred in making gifts as was the expense here involved, but in managing trust property held by them for the benefit of the decedent's legatees. Unlike the administration expenses of the Bingham trustees, the gift expense

here involved bore no relation to the "management" of property held for the production of income. Nor was taxpayer under a fiduciary duty to distribute property committed to his trust, as were the Bingham trustees. To use the language of this Court in the *Bingham* case, the taxpayer's act of making a gift was not a part of the "duties of * * * trustees" nor "an integral part of carrying out [a] trust enterprise"; and his expenses connected with the gift were not "expenses of a function of 'management'." The very considerations which impelled this Court in the *Bingham* case to hold that the administration expenses of a trust are within the purview of Section 23(a)(2) would seem to require an opposite conclusion with respect to personal expenses incurred by a donor in making a gift. See *Commissioner* v. *Heide*, 165 F. 2d 699 (C.A. 2d); *Commissioner* v. *Josephs*, 168 F. 2d 233 (C.A. 8th); *Bagley* v. *Commissioner*, 8 T.C. 130.

In the only case (other than the instant one) involving the deductibility of expenses incurred in contesting a gift tax deficiency, both the Tax Court and the Court of Appeals have held that such expenses do not qualify for deduction under Section 23(a)(2). *Cobb* v. *Commissioner*, 10 T.C. 380, affirmed, 173 F. 2d 711 (C.A. 6th), certiorari denied, 338 U.S. 832, rehearing denied, 338 U.S. 882. The opinion of the Court of Appeals in that case fully distinguishes the *Bingham* case, and substantially the same arguments as taxpayer here advances were there rejected. The Court of Appeals in the

Cobb case refused (p. 715) to "adopt the impractical concept that giving away property produces income to the donor, or constitutes either management or conservation of the property." We believe that the reasoning of the court in that case, concurred in by the court below (R. 36), is sound and effectively disposes of taxpayer's contentions here.

II

The Treasury Regulation Barring the Claimed Deduction Is Valid

Congress has authorized the Commissioner, with the approval of the Secretary of the Treasury, to issue and publish interpretive regulations under the Internal Revenue Code. (Sections 62 and 3791 of the Internal Revenue Code).[11] The opening portion of Section 29.23(a)-15 of Treasury Regulations 111, which deals with the deductibility of expenses under Section 23(a)(2), provides that—

> * * * Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

[11] The taxpayer attacks the regulation as not being the type which Congress authorized, on the ground that it purports to apply the general law to a specific situation (Br. 20). The tax regulations have for years abounded with this type of interpretation, and never has Congress or the courts questioned the propriety of such regulations. In fact, they are necessary to inform taxpayers how the Commissioner will apply the law to specific common situations. The validity of such regulations stands or falls on whether they are within the scope of the statutory provision they purport to apply.

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income, and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

Following the decision of this Court in the *Bingham* case, Section 29.23(a)-15(b) of the Regulations was amended by T.D. 5513, 1946-1 Cum. Bull. 61, to provide that—

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, * * *
Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability as-

> serted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. *Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability* or even though, in the event of a claim for refund, the amount received will be held by him for the production of income. [Italics supplied.]

This Court has (*Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501) "many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." See also *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378; *Brewster* v. *Gage*, 280 U.S. 327; *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90; *Helvering* v. *Reynolds Co.*, 306 U.S. 110. This admonition applies to amendments or clarifications made "to meet administrative exigencies or to conform to judicial decision." *Morrissey* v. *Commissioner*, 296 U.S. 344, 355.

The District Court held (R. 30-31) that insofar as the regulation precludes the deduction of expenses incurred in determining gift tax liability it is in conflict with the statute and unauthorized. Far from being in conflict with the statute, the regulation represents, as the court below held (R. 37), "a reasonable and consistent interpretation" of the Congressional intent disclosed by the language of the statute and its background. The most that may be said in taxpayer's favor is that the provisions of Section 23(a)(2) are susceptible of more than one reasonable interpretation insofar as gift tax litigation expenses are concerned. Even assuming that the interpretation which taxpayer urges and the District Court adopted is reasonable, however, certainly the Treasury's interpretation is not any the less reasonable. *Morrissey* v. *Commissioner, supra,* pp. 354,356. The Regulation constitutes a construction of the statute by the department charged with the duty and responsibility of its administration. It cannot be said to be so "plainly inconsistent" (*Commissioner* v. *South Texas Co. supra,* p. 501) with the statute as to be arbitrary and unauthorized, especially in the light of the rule, often reiterated by this Court, that deduction provisions are matters of legislative grace and must be strictly construed.

Furthermore, since the above provisions of the regulation were promulgated, Congress has several times extensively amended the Internal Revenue

Code[12] without changing the statutory provision to which they are addressed. Under familiar rules governing the construction of taxing statutes, the Treasury's interpretation must be deemed to have received implied legislative approval by virtue of substantial reenactment of the statute. *Helvering* v. *Winmill,* 305 U. S. 79, 83; *Commissioner* v. *Flowers,* 326 U. S. 465, 469; *Boehm* v. *Commissioner,* 326 U. S. 287.

The provisions of the regulation denying the deduction of expenses incurred in litigating *gift* tax liability are not, as taxpayer charges, inconsistent with those permitting the deduction of expenses incurred in litigating *income* tax liability.[13] The income tax is imposed upon net "income" earned in a taxable year (Code Section 11), while the gift tax is imposed "upon the transfer * * * of property" (Section 1000(a)); and expenses incurred in litigating the two types of taxes may not be assimilated for purposes of applying the business and non-business expense deduction provisions of the income taxing statute. Expenses of contesting income tax liability imposed on business or non-business income are directly related to

[12] E.g., Revenue Act of 1948, c. 168, 62 Stat. 110; Revenue Act of 1950, Public Law 814, 81st Cong., 2d Sess.; Revenue Act of 1951, Public Law 183, 82nd Cong., 1st Sess.

[13] In the *Bingham* case, the expenses incurred by the trustees in contesting the income tax deficiency asserted against the trust were held deductible on the ground (p. 376) that these expenses, like the other administration expenses of the trust, were directly connected with the "management" of the trust property.

the production of the income or to the management of property which produces the income.[14] Expenses of contesting gift tax liability lack this essential relationship, since they are directly related to a *transfer* of property from one taxpayer to another, a personal transaction unrelated to the production of business or non-business income or to the management of the property which produces it. *Cobb* v. *Commissioner, supra.* See 63 Harv. L. Rev. 357 (1949). Expenses incurred in resisting gift tax liability are no more proximately related to the production of income or the management of income-producing property than expenses incurred in defending any personal law suit.

III.

The Court Below Did Not Exceed Its Reviewing Powers in Reversing the District Court

There is no merit in taxpayer's contention that this case presents a question of "fact", with respect to which the District Court's decision is entitled to

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[14] As was pointed out in *Kornhauser* v. *United States*, 276 U.S. 145, 153, in connection with business expenses, there is no real difference between an expenditure for attorney's fees made to secure payment of business income and a like expenditure to retain such income after its receipt. One is as directly connected with the business (under Section 23(a)(2) with the enterprise of producing and collecting income) as the other. See also *Commissioner* v. *Heininger, supra.* Litigation expenses incurred in contesting *gift* tax liability are not directly related to the production or retention of income; on the other hand, expenses incurred by the donor in seeking to deduct such expenses in computing his *income* tax are so related.

finality. The crucial and undisputed fact dispositive of this case is that the expense in question was incurred in litigating gift tax liability. Whether an expense of this nature is deductible under Section 23(a)(2) presents a reviewable question of law turning on the meaning of the words of that section. In the *Bingham* case, upon which taxpayer relies, this Court stated (p. 371):

> The questions whether, on the facts found, the expenses in question are nondeductible, either because they were not to produce income or because they were related to the management of property which was not held for the production of income, turn in this case on the meaning of the words of § 23 (a) (2), "property held for the production of income." They are therefore questions of law, decision of which is unembarrassed by any disputed question of fact or any necessity to draw an inference of fact from the basic findings. * * * They are "clear cut" questions of law, decision of which by the Tax Court does not foreclose their decision by appellate courts * * *.

Furthermore, the District Court made no attempt to determine whether the expense in question was directly connected with or proximately resulted from activity described in Section 23(a)(2). It reached its decision not by making a factual determination as to whether the expense falls

within the class allowed by the statute, but because of the mistaken conviction that its allowance was required as a matter of law. It assumed that such result was demanded by the decision of this Court in the *Bingham* case and, moreover, that the applicable Treasury Regulation, as amended after the *Bingham* decision, was in conflict with the statute and that decision (R. 30-31). It thereby adopted a general rule applicable to all gift tax litigation expenses, and its decision is therefore one of law clearly subject to a broader appellate review than that appropriate with respect to factual issues. *Commissioner* v. *Heininger, supra*, pp. 470-471, 475; *McDonald* v. *Commissioner, supra*, p. 64; cf. *Commissioner* v. *Estate of Bedford*, 325 U. S. 283; *Dobson* v. *Commissioner*, 320 U. S. 489, 502.

In any event, assuming that this case presents only a question of fact, reversal of the District Court's decision by the court below was nevertheless correct for the reason that the decision of the District Court is "clearly erroneous" in the light of the undisputed fact that the expense was incurred in contesting gift tax liability, and the inescapable conclusion that the expense was directly connected with a gift of property. Rule 52(a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.*, 333 U. S. 364, 395; *United States* v. *Yellow Cab Co.*, 338 U. S. 338, 340-342.

Equally untenable is taxpayer's suggestion that

this case must be remanded to the District Court for additional findings of fact. There is no further evidence or finding which could conceivably erase the critical fact that the expense was incurred in litigating gift tax liability. Remand of the case would therefore be futile. *General Utilities Co.* v. *Helvering*, 296 U. S. 200, 206-207; *Estate of Spiegel* v. *Commissioner*, 335 U. S. 701, 707; *Hormel* v. *Helvering*, 312 U. S. 552, 559-560.

CONCLUSION

The judgment of the Court of Appeals is correct and should be affirmed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ELLIS N. SLACK,
Acting Assistant Attorney General.

JOHN F. DAVIS,
HARRY BAUM,
Special Assistants to the Attorney General.

NOVEMBER, 1951.

APPENDIX A

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he had no equity.

* * * * * *

(2) *Non-trade or non-business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

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(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

* * * * *

(26 U.S.C. 1946 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23(a)-15. *Nontrade or Nonbusiness Expenses.*

(a) *In general.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23 (a) (2) comprehends not merely in-

come of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter incurred in connection therewith are deductible. Similarly, ordinary and necessary expenses incurred in the management, conservation or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses incurred in managing, conserving, or maintaining property held for investment may be deductible under this provision even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of prop-

erty held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) [as amended by T.D. 5513, 1946-1 Cum. Bull. 61, 62] Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. Section 24 (a) (5) disallows any amount otherwise allowable as a deduction (whether under section 23 (a) (2) or otherwise) which is allocable to one or more classes of tax-exempt income, other than interest, and has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts otherwise allowable under that section which are allocable to tax-exempt interest. Thus, any amount allocable to the production or collection of one or more classes of income which is not includible in gross income or to the management, conservation, or main-

tenance of property held for the production of such income is not deductible under section 23 (a) (2). Nor does section 23 (a) (2) allow any expenses which are disallowed by any of the provisions of chapter 1.

* * * * * *

Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a)(2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

* * * * * *

Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under this section, notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 29.162-1 for disallowance of such deductions to an estate where such items are

claimed as a deduction under section 812 (b) in computing the net estate subject to the estate tax.

Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring to the ward or minor, or in connection with the management, conservation, or maintenance of property, held for the production of income, belonging to the ward or minor, are deductible.

Expenditures incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible, but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenditures incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible expenses. Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property

tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

* * * * *

APPENDIX B

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 46, 74-75 (1942-2 Cum. Bull. 372, 410, 429-430):

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of

property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable.

* * * * *

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section it must have been incurred either (1) for the production or collection of income or (2) for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a)(2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term "income" for this purpose

comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction, under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section

24 (a)(5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a)(2) or otherwise, which is allocable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a)(2) for amounts allowable under that section which are allocable to tax-exempt interest.

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S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 87-88 (1942-2 Cum. Bull. 504, 570-571), is substantially the same.

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